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Supreme Court of the United States

October Term, 1944

No. 515

FERDINAND W. ROEBLING, III,
Petitioner,
vs.
COMMISSIONER OF INTERNAL REVENUE,
Respondent.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT

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COMMISSIONER OF INTERNAL REVENUE,
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PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT

The petitioner, Ferdinand W. Roebling, III, prays that a writ of certiorari issue to review the judgment of the United States Circuit Court of Appeals for the Third Circuit in the above case affirming a decision of The Tax Court of the United States.

Opinions Below

The memorandum opinion of The Tax Court (R. 15-25) is unreported. The opinion of the Circuit Court of Appeals .....F. (2d) .....appears at pages 38-46 of the Record.

Jurisdiction

The judgment of the Circuit Court of Appeals was entered on July 1, 1944 (R. 46). The jurisdiction of this

Court is invoked under Section 240(a) of the Judicial Code, as amended by the Act of February 13, 1925. (U. S. C., Title 28, Section 347(a); see also U. S. C., Title 26, Section 1141(a).)

Questions Presented

1. Should the recognition of gain from the exchange of certain stock for 100-year non-callable bonds pursuant to a statutory merger be deferred under section 112(b)(3) of the Revenue Act of 1938?

(a) Does a merger of one corporation into another in accordance with the corporation laws of New Jersey constitute a reorganization under section 112(g)(1)(A) of the Revenue Act of 1938?

(i) Does the continuity of interest test as applied in *LeTulle* v. *Scofield*, 308 U. S. 415, have any application in the case of a true merger consummated in accordance with state law after the amendments to the reorganization provisions contained in the Revenue Act of 1934 and subsequent acts?

(ii) In any event, under the peculiar facts in this case, is the requisite continuity of interest present?

Statutes, Regulations & Committee Reports

New Jersey Statutes

The pertinent provisions of The General Corporation Law of New Jersey appear at pages 26-28 of the Record.

Federal Statutes

Revenue Act of 1938, c. 289, 52 Stat. 447:

"Sec. 112. Recognition of Gain or Loss.

"(a) *General Rule.*—Upon the sale or exchange of property the entire amount of the gain or loss, determined under section 111, shall be recognized, except as hereinafter provided in this section.

"(b) *Exchanges Solely in Kind.*—

" * * * * * *

" * * * * * *

"(3) Stock for stock on reorganization.—No gain or loss shall be recognized if stock or securities in a corporation a party to a reorganization are, in pursuance of the plan or reorganization, exchanged solely for stock or securities in such corporation or in another corporation a party to the reorganization.

* * * * * * *

"(g) *Definition of Reorganization.*—As used in this section and section 113—

"(1) The term 'reorganization' means (A) a statutory merger or consolidation, or (B) the acquisition by one corporation in exchange solely for all or a part of its voting stock: of at least 80 per centum of the voting stock and at least 80 per centum of the total number of shares of all other classes of stock of another corporation; or of substantially all the properties of another corporation, or (C) a transfer by a corporation of all or a part of its assets to another corporation if immediately after the transfer the transferor or its shareholders or both are in control of the corporation to which the assets are transferred, or (D) a recapitalization, or (E) a mere change in identity, form, or place of organization, however effected.

"(2) The term 'a party to a reorganization' includes a corporation resulting from a reorganization and includes both corporations in the case of a reorganization resulting from the acquisition by one corporation of stock or properties of another."

REGULATIONS

Treasury Regulations 101, promulgated under the Revenue Act of 1938:

"Art. 112(g)-2. *Definition of terms.*—The application of the term 'reorganization' is to be strictly limited to the specific transaction set forth in section 112(g)(1). The term does not embrace the mere purchase by one corporation of the properties of another corporation, for it imports a continuity of interest on the part of the transferor or its stockholders in the properties transferred. If the properties are transferred for cash and deferred payment obligations of the transferee evidenced by short-term notes, the transaction is a sale and not an exchange.

"The words 'statutory merger or consolidation' refer to a merger or a consolidation effected in pursuance of the corporation laws of the United States or a State or Territory or the District of Columbia.

* * * * * * *

"The term 'a party to a reorganization' includes, in addition to a corporation which performs the specific act constituting the reorganization as described and defined in section 112(g)(1), only a corporation specified in section 112(g)(2). Both corporations are parties to the reorganization if under statutory authority Corporation A is merged into Corporation B;

* * * * * * *

"Art. 112(g)-3. *Exchanges solely of stock or securities, or property, solely for stock or securities, in pursuance of plan of reorganization.*—No taxable income is received, nor is a deductible loss sustained, if the shareholders in a corporation a party to the following reorganization transactions exchange stock or securities solely for stock or securities of the same corporation, or of another corporation mentioned, or if one of such corporations transfers property to another of the corporations solely for stock or securities of such other corporation, in pursuance of the plan of reorganization:

"(1) The merger of Corporation A, in accordance with statutory authority, into Corporation B;"

COMMITTEE REPORTS

The parts of the reports of the Committee on Ways & Means and of the Committee on Finance dealing with "Exchanges & Reorganizations" under the Revenue Bill of 1934 are reproduced in full at pages 31-36 of the Record.

Statement

This proceeding originated in The Tax Court of the United States, which entered an order redetermining petitioner's income taxes for 1938 (R. 25). The issue is one of law. The facts as stipulated are fairly summarized in the Memorandum Opinion of The Tax Court (R. 15-25).

(1) In 1938 petitioner owned 166 shares of stock in South Jersey Gas, Electric & Traction Company (hereinafter called South Jersey) which had a tax basis in his hands of par, or $16,600 (R. 16).

(2) Since 1903 all the properties of South Jersey had been under lease for a 900-year term. The lease, after relieving South Jersey of all carrying charges, provided for a cash rental exactly sufficient to permit the payment to the stockholders of South Jersey of a dividend of 8% per annum on the par value of its capital stock and a cash dividend at that rate was regularly paid (R. 16-17).

(3) In November 1938, in order to eliminate this highly objectionable lease on the best possible terms,[1] South Jersey, the lessor, was merged into Public Service Electric & Gas Company, the lessee, in strict accordance with the corporation laws of New Jersey. This was accomplished under a plan of reorganization and a formal Agreement of Merger by the exchange of South Jersey stock, par for par, for 100-year non-callable 8% bonds of Public Service Electric & Gas Company, the continuing company. This plan was adopted in order to meet the tests prescribed

[1]See, Findings and Opinion of Federal Power Commission (R. 3-15).

by the New Jersey courts in *Outwater* v. *Public Service Corporation*, 103 N. J. Eq. 461, 143 Atl. 729, *aff'd*, 146 Atl. 916 (R. 17-21). Both The Tax Court (R. 23) and the Circuit Court of Appeals (R. 42) accepted the transaction as a true statutory merger under New Jersey law.

(4) In the transaction, the petitioner received in exchange for his 166 shares of South Jersey stock, having a tax basis of par, $16,600 principal amount of 100-year non-callable 8% bonds of Public Service Electric & Gas Company which had a fair market value of $34,777 (R. 21).

(5) The Commissioner of Internal Revenue determined that the difference between the basis of petitioner's stock in South Jersey and the fair market value of the bonds received in exchange therefor must be recognized as taxable income in 1938. The Tax Court and the Circuit Court of Appeals sustained that determination.

(6) The petitioner contends that the merger of South Jersey into Public Service Electric & Gas Company pursuant to the laws of the State of New Jersey, being a statutory merger, constituted a reorganization under section 112(g)(1)(A) of the Revenue Act of 1938, and that under section 112(b)(3) of that Act, the gain from the exchange by the petitioner, pursuant to such reorganization, of his stock in South Jersey for securities of the continuing company is not presently recognized. More specifically, he contends that the continuity of interest test, as applied in *LeTulle* v. *Scofield*, 308 U. S. 415, has no application in the case of a true merger consummated in accordance with State law after the amendments to the reorganization provisions contained in the Revenue Act of 1934 and subsequent Acts. In any event, he contends that, under the peculiar facts in this case, the requisite continuity of interest is present.

Specification Of Errors To Be Urged

The Circuit Court of Appeals erred:

(1) In holding that the recognition of petitioner's gain from the exchange of his South Jersey stock for 100-year non-callable 8% bonds of Public Service Electric & Gas Company pursuant to a statutory merger should not be deferred under section 112(b)(3) of the Revenue Act of 1938.

(2) In holding that a "true statutory merger" under New Jersey law is not a "statutory merger" within the meaning of section 112(g)(1)(A) of the Revenue Act of 1938.

(3) In holding that the continuity of interest test, as applied in *LeTulle* v. *Scofield*, 308 U. S. 415, is applicable in the case of a true merger consummated in accordance with state law after the amendments to the reorganization provisions contained in the Revenue Act of 1934 and subsequent Acts.

(4) In failing to hold that in any event under the peculiar facts in this case the requisite continuity of interest was present.

Reasons For Granting The Writ

The Circuit Court of Appeals in holding that the continuity of interest doctrine developed by this Court under the loosely worded definition of the term, reorganization, contained in the Revenue Acts of 1924, 1926, 1928 and 1932 should be applied to the precisely worded amended definition contained in the Revenue Act of 1934 and subsequent Acts, has decided an important question of Federal tax law which has not been, but should be, settled by this Court.

Section 112(i)(1) of the Revenue Act of 1932 and corresponding sections of the three earlier Acts provided that the term, reorganization, means, among other things:

> "(A) *a merger or consolidation (including the acquisition by one corporation of* at least a majority of the voting stock and at least a majority of the total number of shares of all other classes of stock of another corporation, or *substantially all the properties of another corporation),* * * * " [Italics ours]

This definition failed to spell out with precision the types of transactions contemplated as reorganizations by the parenthetical clause. A literal interpretation would have embraced sales for cash or short-term purchase money notes. In order to avoid that result, the continuity of interest test was developed as a gloss upon the generality of the language contained in the parenthetical clause. *Cortland Specialty Company* v. *Commissioner* (1932), 60 F. (2d) 937 (C. C. A. 2d); *Pinellas Ice & Cold Storage Company* v. *Commissioner* (1933), 287 U. S. 462; *Helvering* v. *Minnesota Tea Co.* (1935), 296 U. S. 378; *John A. Nelson Co.* v. *Helvering* (1935), 296 U. S. 374; *Helvering* v. *Watts* (1935), 296 U. S. 387; *LeTulle* v. *Scofield* (1940), 308 U. S. 415; *Helvering* v. *Alabama Asphaltic Limestone Company* (1942), 315 U. S. 179.

All of these cases arose under the parenthetical clause. In the *Pinellas* case this Court held that the parenthetical clause was intended to bring within the scope of the definition of a reorganization, transactions that fall short of meeting the tests of a true merger or consolidation. In the *LeTulle* case it was held that the transfer of assets for long-term bonds or part cash and part such bonds did not meet the test. And in the *Alabama Asphaltic Limestone Co.* case, this Court pointed out that "the *Pinellas* case introduced the continuity of interest theory to eliminate those transactions which had no real semblance to a merger or consolidation. * * *" (Page 182)

With the decision of this Court in the *Pinellas* case before it, Congress, in section 112(g)(1) of the Revenue

Act of 1934, rewrote the definition of the term, reorganization.

The following is a comparative print of section 112(g)(1) showing the changes in existing law made by the Revenue Bill of 1934 as it passed the House:

> "~~(1)~~ *(g)* DEFINITION OF REORGANIZATION.—As used in this section and ~~sections 113 and 115~~ *section 113*—
>
> "(1) The term 'reorganization' means (A) a merger or consolidation ~~(including the acquisition by one corporation of at least a majority of the voting stock and at least a majority of the total number of shares of all other classes of stock of another corporation, or substantially all the properties of another corporation)~~, or (B) a transfer by a corporation of all or a part of its assets to another corporation if immediately after the transfer the transferor or its stockholders or both are in control of the corporation to which the assets are transferred, or (C) a recapitalization, or (D) a mere change in identity, form, or place or organization, however effected." [H. R. 7835, 73d Cong., 2d Sess. (1934) 85-86]

It will be seen that in the House Bill the parenthetical clause was completely eliminated. In its report accompanying the bill the Committee on Ways and Means said:

> "In the second place, the definition of a reorganization has been restricted so that the definition will conform more closely to the general requirements of corporation law, and will limit reorganizations to (1) statutory mergers and consolidations; (2) transfers to a controlled corporation, 'control' being defined as an 80-percent ownership; and (3) changes in the capital structure or form of organization.
>
> "By these limitations the committee believes that it has removed the danger that taxable sales can be cast

into the form of a reorganization, while at the same time, legitimate reorganizations, required in order to strengthen the financial condition of the corporation, will be permitted. * * *" [H. Rept. 704, 73d Cong., 2d Sess. (1934) 14]

The following is a comparative print of section 112(g)(1) showing the changes in the House Bill as it passed the Senate and as it was enacted:

"(1) The term 'reorganization' means (A) a ~~merger or consolidation, or (B)~~ *statutory merger or consolidation, or (B) the acquisition by one corporation in exchange solely for its voting stock: of at least 80 per centum of the voting stock and at least 80 per centum of the total number of shares of all other classes of stock of another corporation; or of substantially all the properties of another corporation, or (C)*, a transfer by a corporation of all or a part of its assets to another corporation if immediately after the transfer the transferor or its stockholders or both are in control of the corporation to which the assets are transferred, or ~~(C)~~ *(D)* a recapitalization, or ~~(D)~~ *(E)* a mere change in identity, form, or place or organization, however effected." [H. R. 7835, 73d Cong., 2d Sess. (1934) 68]

It will be seen that in the bill as it passed the Senate and as it was finally enacted, the word "statutory" was inserted before the terms "merger or consolidation" in Clause (A) and a new Clause (B) was added embracing the acquisition by one corporation of stock or of substantially all the properties of another corporation. This new Clause (B) embraced the same types of transactions as were covered in the parenthetical clause of prior acts, but it was provided that such acquisitions must be in exchange *solely* for voting stock. Thus, in continuing in the definition of a reorganization the types of transactions previously covered by the old parenthetical clause, the Senate and ultimately the Congress, in Clause (B), but not in Clause

(A), imposed its own requirement of a "continuity of interest". [See *Helvering* v. *Southwest Consolidated Corp.*, 315 U. S. 194, 198.]

In its report accompanying the bill, the Committee on Finance said:

> "Your committee is in complete agreement with the purposes of the House bill which aim at tax-avoidance schemes in this connection. However, some modifications are recommended in order to bring about a more uniform application of the provisions in all 48 of the States. *Not all of the States have adopted statutes providing for mergers or consolidations; and, moreover, a corporation of one State cannot ordinarily merge with a corporation of another State.* The committee believes that it is desirable to permit reorganizations in such cases, with restrictions designed to prevent tax avoidance. Consequently, the committee recommends the insertion in the House bill of an addition to the definition of the term 'reorganization' as follows:
>
> "(B) the acquisition by one corporation in exchange solely for its voting stock: of at least 80 per centum of the voting stock and at least 80 per centum of the total number of shares of all other classes of stock of another corporation; or of substantially all the properties of another corporation;
>
> "The committee believes that these transactions, when carried out as prescribed in this amendment, are in themselves sufficiently similar to mergers and consolidations as to be entitled to similar treatment. It will be noted that the proposed amendment requires that (1) the acquiring corporation must obtain at least 80 per cent of the voting stock and at least 80 per cent of the total number of shares of all other classes of stock of the other corporation, instead of only a majority as provided by the present law; and (2) the acquisition, whether of stock or of substantially all the properties, must be in exchange solely for the voting stock of the acquiring corporation." [S. Rept. 558, 73d Cong., 2d Sess. (1934) 16-17] (Italics ours)

The fact that Clause (B) was added because of the absence of merger and consolidation statutes in some states is affirmative evidence of the deliberate intention of Congress to accept as reorganizations those mergers and consolidations that are effected in accordance with the requirements of those states that do have such statutes. (See Paul, *Selected Studies in Federal Taxation* (1938), Second Series, p. 7; Paul, *Studies in Federal Taxation* (1940), Third Series, p. 60.) The definition of a reorganization as thus amended in the Revenue Act of 1934 was carried forward unchanged in the Revenue Acts of 1936 and 1938.

The parenthetical clause is gone from the statute. Its place has been taken by Clause B of the definition. It is evident that Congress was aware of and in agreement with the continuity of interest test evolved by this Court and wrote it into the statute in express terms and in stricter form than this Court had applied it. But it was written into Clause B only. The several clauses are mutually exclusive. *Helvering* v. *Minnesota Tea Co.*, 296 U. S. 378, 384. Congress made Clause A more precise by placing "statutory" as a qualification of "merger or consolidation" and it left the remaining clauses unchanged. Manifestly it intended that such continuity of interest as is inherent in all true mergers would suffice. There is, therefore, no justification for the courts to wrench that test out of the setting in which necessity gave it birth and to ingraft it on precise, carefully chosen statutory language in which such necessity does not inhere.[2]

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[2]The Circuit Court of Appeals gave scant consideration to the legislative history of the amended definition. It held that its previous decision in *Commissioner* v. *Gilmore's Estate*, 130 F. (2d) 791, was "completely dispositive" of the issue (R. 42). It also cited *Morgan Manufacturing Co.* v. *Commissioner*, 124 F. (2d) 602 (C. C. A. 4th) and the decision of this Court in *Helvering* v. *Southwest Consolidated Corp.*, 315 U. S. 194. None of these cases involved the precise point presented here.

The statutes of New Jersey provide in all respects for a true corporate merger within the conventional meaning of that term (R. 26-28). The merger here involved was adopted to meet the tests prescribed by the New Jersey courts in *Outwater* v. *Public Service Corporation*, 103 N. J. Eq. 461, 143 Atl. 729, *aff'd*, 146 Atl. 916. The desirability of the merger is fully demonstrated by the opinion of the Federal Power Commission (R. 3-15). It is clear from the *Outwater* case that Congress, in adopting the standards of New Jersey, could be assured, in the words of the Committee on Ways & Means, that it had "removed the danger that taxable sales could be cast in the form of a reorganization" (R. 34).

Moreover, this is clearly the type of case intended by Congress to be embraced within the non-recognition provisions. Prior to the merger, the stockholders of South Jersey had no voice in the management or operation of the properties and yet they were assured in practical perpetuity of a return of 8% in the form of dividends regardless of the earnings of the particular properties. After the merger, these same stockholders still had no voice in the management and yet they were assured of a return of 8% for 100 years in the form of interest, regardless of the earnings of the properties. Under the test laid down in the *Outwater* case, this provided the stockholders of the lessor with "participation in the merged company relatively as they enjoyed that right in the merging companies". (143 Atl. 729) It was in a very real sense, in the words of the regulations, a "readjustment of continuing interests under modified corporate forms" (R. 30).

During and since 1938, other mergers identical with that involved in this case, have been consummated under the merger statutes of New Jersey and the tax liabilities of a large number of participating stockholders are necessarily involved. The instant proceeding was, therefore,

selected as a test case.[3] The question here presented is also necessarily involved in the cases of all mergers under the laws of other states which permit the exchange of stock for long-term bonds of the continuing companies. The question is obviously one of far-reaching importance. If this case is not reviewed there will be further litigation in other circuits. Since this Court developed the continuity of interest doctrine for a specific purpose under earlier statutes, it should now supervise the attempted extension of that doctrine to different and later statutes, even though there is no presently existing conflict of decisions between circuits.

Conclusion

It is respectfully submitted that this petition for a writ of certiorari should be granted.

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[3]Direct evidence of two other such mergers appear in this Record (R. 3). There is on file in the Circuit Court of Appeals an exhibit, not included in the present Record, which contains direct evidence of two additional mergers. Moreover, we are informed by officials of Public Service Electric & Gas Company that four gas companies were brought in under identical mergers in 1940.